The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

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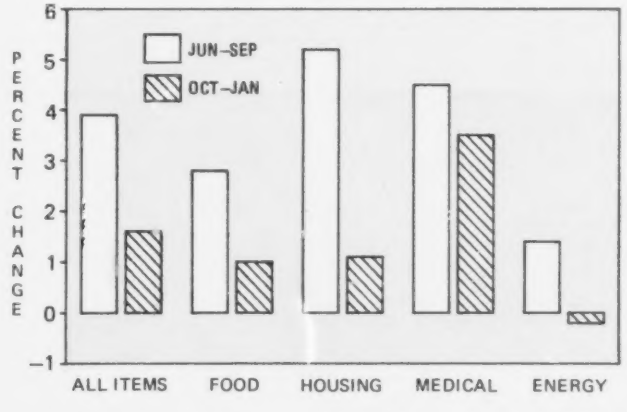
For Consumer Prices . . .

One of the more favorable economic developments occurring in recent months – if not the only one – has been the marked deceleration in the rate of inflation. This trend continued in January. The consumer price index (CPI) rose a seasonally adjusted 0.3 per cent during the month, following an increase of 0.4 per cent in December and 0.5 per cent in November. In the past four months, the CPI has advanced at a seasonally adjusted annual rate just a shade below five per cent – sharply lower than the almost 12 per cent rate of rise posted during the four months ending September 30. What is more, a variety of factors points toward moderate rates of inflation well into the future, although probably not as low as those of recent months.

The upward movement of several of the most important components of the index has, in many instances, virtually ceased–with some items even declining. As shown in the chart, the most pronounced slowing in the rate of price advance during the October-January period has been in precisely those areas which, in the past, have contributed to

THE CONSUMER PRICE INDEX AND SELECTED COMPONENTS
(FOUR-MONTH PERCENT CHANGES)



the steep escalation of the CPI, such as housing, energy and food prices. And while much of the balance of the improved inflation rate performance is undoubtedly due to the price "benefits" of recession, together these have become the necessary first step in bringing down the "core" rate of inflation, determined by the long-term relationship between wages and productivity. With expectations high that the good inflation news of 1981 and early 1982 can be carried over into wage settlements and cost-of-living adjustments this year, it is increasingly likely that the underlying rate of inflation can be reduced further.

But, for now, the partial unwinding of the steep escalation of energy prices and housing costs has been largely responsible for the improved price performance. With the worldwide oil glut becoming more pronounced each day, major OPEC and non-OPEC oil producers slashing export prices and domestic refiners attempting frantically to move still sizable oil inventories, the rise in energy prices has ceased. Motor gasoline prices, for example, have been ratcheting downward since reaching their peak in March, 1981; in January, they stood almost 3.5 per cent below that peak. Similarly, residential heating oil prices have remained flat, despite severe winter weather conditions in many areas of the country. As a result, energy prices, as measured by the CPI, actually declined 0.2 per cent during the October-January months, an exceedingly sharp turnaround when compared with the almost 1.5 per cent rise posted during the immediately preceding four months.

The leveling off of housing costs–the largest component of the CPI–was also a major contributor to the slowing of the rate of inflation. With home prices soggy due to the ongoing crisis in mortgage finance, it is hardly surprising that the home purchase component of the CPI has drifted downward since September, and declined 0.4 per cent in January alone. Even financing costs have held relatively steady in recent months, largely reflecting some moderation in the upward spiral of mortgage interest rates.

. . . More Good News . . .

Rising by almost 10 per cent during the June-September months–and responsible alone for about one-third of the overall rise in the index during the period–financing costs edged up by less than one

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per cent in the subsequent four months. Nor is any quick turnaround of these trends in sight. Home prices will undoubtedly remain flat as long as mortgage interest rates remain at, or near, today's levels. For their part, mortgage interest rates are unlikely to rise sharply again (thus contributing to an increase in housing costs) as long as inflation psychology remains dormant.

The moderation of energy and housing costs was, however, partially offset by an abrupt upturn in food prices. They rose 0.7 per cent in January, following a 0.1 per cent increase in December. The jump in food prices was largely due to the recent severe winter weather conditions in many areas of the country (which damaged fruit and vegetable crops) and will probably be of limited duration. The onset of milder weather conditions should help prevent any additional damage to crops, which, in turn, could indicate that the worst of the food price bulge may be over. Indeed, the spot price index for foodstuffs has already begun to decline again—falling for three consecutive weeks, after peaking in late January.

Medical costs are still climbing swiftly. In January, they rose 0.8 per cent, following a 0.7 per cent month-over-month rise in December. Medical care is now the fastest rising component of the price index, advancing at a seasonally adjusted annual rate of almost 11 per cent during the four months ending January 31. Although this rate of rise was

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 2/17/82	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	136.683	+ 2.555	+10.596
Loans to Depository Inst.	1.908	+ .244	+ .763
Float	2.539	– .679	– 1.206
Total Reserve Bank Credit	151.146	+ 2.468	+ 9.865
Treasury Deposits with Federal Reserve Banks	4.568	– .751	+ 1.736
Currency Outside Banks	126.001	+ 1.375	+ 6.156
Member Bank Reserves:			
Required	41.457	+ .926	+ 1.697
Excess (Deficiency)	.677	+ .500	+ .379
Total Reserves Held	42.134	+ 1.426	+ 2.076
Net Borrowed Reserves	+ 1.097	– .276	+ .404
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	93.641	– 2.383	– .443

Monetary Aggregates†		% Change Since Three Months Ago*	% Change Since Year Ago
M1	447.7	+ 11.7‡	+ 7.0‡
M2 (January '82)	1,839.8	+ 11.3	+ 10.5
M3 (January '82)	2,203.7	+ 9.8	+ 11.1
L (October '81)	2,598.2	+ 10.7	+ 11.6

†Seasonally adjusted. *Seasonally adjusted annual rate. ‡Four-week moving average.

New York Money Market

Offering Rates 2/26/82	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	12.20%	12.75%	12.50%
* Federal Agencies	12.85	13.85	13.75
* Project Notes–Taxfree (46% Taxable Equivalent)	13.52	13.89	NA
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	14.25	14.50	15.38

‡Finance Company Paper–Prime		‡* Bankers' Acceptances	
5- 14 days	13.13%	Mar.	13.40%
15- 29 days	13.38	Apr.	13.40
30- 59 days	13.38	May	13.45
60- 89 days	12.88	Jun.	13.45
90-179 days	12.88	Jul.	13.45
180-239 days	12.88	Aug.	13.30
240-270 days	12.88		

‡Industrial Paper–Prime			
30- 89 days	13.50%	†Federal Funds Effective Rate	13.65%
90-120 days	13.50		

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	4th Q'81	$ 2,995	$ 2,965	$ 2,731
Gross National Product (1972 Dollars)*	4th Q'81	$ 1,498	$ 1,516	$ 1,486
Percent Change, Annual Rate	4th Q'81	– 4.7	1.4	3.8
Change in Consumer Prices (all urban consumers)*	Jan '82n	3.6%	4.8%	9.6%
Change in Producer Prices*	Jan '82	4.8%	3.6%	14.4%
Civilian Employment (Thousands of Persons)†	Jan '82	99,581	99,613	99,901
Unemployment as % of Civilian Labor Force†	Jan '82	8.5%	8.8%	7.4%
Personal Income*	Jan. '82	$ 2,495	$ 2,491	$ 2,301
Leading Indicators Composite Index (1967=100)†	Dec '81	129.4	128.6	136.4
Industrial Production Index (1967=100) †	Jan '82	139.1	143.4	151.4
Net Change in Consumer Installment Credit†	Dec '81	–$ 0.17	$ 0.34	$ 1.62
U.S. Merchandise Trade Balance †	Dec '81	–$ 0.70	–$ 3.40	–$ 2.19
Plant and Equipment Expenditures*	1st Q'82	$345.46(a)	$332.69(a)	$312.24
Private Housing Starts (Thousands of Units)*	Jan '82	894	899	1,585
New Construction Expenditures*	Dec '81	$ 229.3	$ 231.6	$ 245.4
Total Business Inventories†	Dec '81	$ 513.1	$ 515.2	$ 475.2
Total Business Sales†	Dec '81	$ 343.3	$ 345.2	$ 343.8

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

slightly lower than that posted during the preceding four months, medical costs have still soared by more than 12 per cent over the past year. In fact, the combination of rising medical, food and other service costs will continue to provide some upward thrust to the CPI, but not enough to push up the index significantly faster. Their impact will continue to be largely offset by the dampening effects of declining energy prices and virtually flat housing costs.

. . . But Not Yet For The Budget

Although the moderation in the rate of consumer price inflation was certainly welcome, it will not be sufficient in the near term to assuage the financial markets, thus bringing interest rates noticeably lower. One prerequisite for this to occur would be some good news on the budget and, as of yet, little has been offered. It is true that, according to the Treasury Department, the Federal budget posted a $9.34 billion surplus in January, a sizable turnaround compared with the $19.47 billion deficit registered in the preceding month. But it is also true that this black ink total was largely due to the mailing of January Social Security checks in December, rather than any fundamental improvement of Federal finances.

Still, the fiscal year to date red ink total now stands at "only" $38.9 billion. This is more than $1 billion below the deficit posted during the same period of fiscal 1981. Then, both the economy and the rate

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CD's Weekly Reporting Banks			
Nationwide (2/10/82)	134,235	– 1,148	+21,190
New York City (2/10/82)	34,559	– 646	+ 6,330
Commercial Paper (2/10/82)	168,068	+ 1,895	+37,082

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (2/10/82)	198,024	+ 15	+27,480
New York City (2/10/82)	56,031	– 318	+ 6,247

Total Loans Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (2/10/82)	468,142	– 2,268	+44,464
New York City (2/10/82)	109,036	– 1,931	+ 9,473

Financial Markets

	Friday 2/26/82	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	12.85%	– .85	– 2.05
180-Day Bills†	13.95	– .39	– 1.04
Longest Bill†	14.10	– .94	– .36
Recent Issues:			
15 1/8s 2/29/84	14.35	– .75	
14 1/8s 12/31/85	14.20	– .32	
14 5/8s 2/15/92	13.99	– .01	
14s 11/15/11	13.80	– .12	
Municipals:			
Bond Buyer–20 Bond Index* (2/25/82)	12.70%	– .26	+ 2.43
Blue List Total ($ Million)	$ 802	+ $ 47	+ $ 1
30-Day Visible Supply ($ Million)	$1,790	+ $353	– $ 197
Total	$2,592	+ $400	– $ 196
Corporates:			
Moody's Aa Composite (2/25/82)	15.46%	– .25	+ 1.39
30-Day Visible Supply ($ Million)	$9,537	+ $125	+ $5,849
Stocks:			
Dow-Jones Averages:			
Industrials	824.39	+ .09	– 150.19
Transportation	336.38	– 6.75	– 55.96
Utilities	107.23	+ 2.32	+ .80
65 Stocks	323.54	– .80	– 46.49
Standard and Poor's 500 Stocks	113.11	– .11	– 18.16
N.Y.S.E. Composite Index	65.33	– .10	– 9.80
N.Y.S.E. Avg. Daily Vol. for Week (000's)	56,242	+ 7,008	+ 7,520

* 46% Taxable equivalent 23.52%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 2/26/82	Week Ago
Overnight	13.38%	15.00%
1 month	14.50	15.50
3 month	14.88	15.63
6 month	15.00	15.69
1 year	15.00	15.50
EURODOLLAR BONDS Average Yield		
Medium Term (5 to 7 yrs.)	14.80%	14.95%
Long Term (7 to 15 yrs.)	14.90	15.10

FOREIGN EXCHANGE SPOT RATES

New York Opening (2/26/82)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02284	43.78
Canada	.8148	1.2273
Denmark	.1257	7.9550
France	.1646	6.0750
Germany	.4194	2.3845
Italy	.0007812	1280.10
Japan	.004216	237.18
Mexico	.02312	43.25
Netherlands	.3824	2.6150
Switzerland	.5284	1.8925
U.K.	1.8165	.5508

of inflation were rising vigorously, thus boosting revenues and dampening counter-cyclical expenditures. What is more, taxes were cut, thus reducing revenues at the start of fiscal 1982.

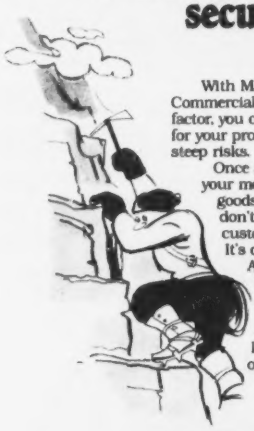
This result can have two interpretations. First, it is possible that the fiscal 1982 deficit will be well below the projected $99 billion. Indeed, if the past is any guide, a continuation of the trends of the first four months of the fiscal year would result in a full year deficit of approximately $55 billion. And, with revenues still holding up surprisingly well despite the weak economy and lower rates of inflation, the possibility of a narrower deficit than now estimated cannot be totally dismissed.

Unfortunately, this year is probably going to be very different than others—especially if the rate of unemployment rises sharply in coming months and the 10 per cent across-the-board cut in personal income taxes takes effect on July 1, as scheduled. As a result, a second interpretation is more likely: This period is the calm before the storm. For if a $99 billion red ink total is, indeed, in store for this year, then a deficit of $60 billion will be recorded over the next eight months. This red ink total would be 3½ times the size of the deficit posted during the final eight months of fiscal 1981 ($17.5 billion)—which, although a period of relatively modest Treasury borrowings, was still characterized by substantial financial market turbulence.

Thus, if the deficit does triple between now and September compared with year-ago levels, the Treasury will be a major net demander of funds during the second and third calendar quarters. During this period in 1981, there was a net paydown of Treasury debt in the second quarter while about $23 billion of net new cash was raised in the third quarter. This suggests that Treasury financing requirements could be soaring at precisely the same time that the private economy is expected to attempt a modest revival—enhancing the likelihood that public and private sector borrowing requirements will clash, interest rates will again rise sharply—and any nascent economic rebound will be choked off. H

monetary muscle

Factoring to help consumer goods manufacturers secure their footing.



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MHCC is recognized among all kinds of industries as a leader in factoring. And with the monetary muscle of the 855-billion Manufacturers Hanover organization behind us, you can be sure we'll be around to deliver on the promises we make.

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